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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 7.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

WILLIAM ALBERT HARRISON.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

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BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 15–18) is reported in 26 B. T. A. 896. The opinion of the Circuit Court of Appeals (R. 25) is reported in 68 Fed. (2d) 1004.

JURISDICTION.

The jurisdiction of this court is by virtue of Section 240 (a) of the Judicial Code, as stated in the petitioner's brief.

QUESTION PRESENTED.

Where the taxpayer elects to be taxed under Section 101 (a) of the Revenue Act of 1928, does "net income," by which the maximum 15 per cent. deduction from gross income allowable for contributions under Section 23 (n) of the Revenue Act of 1928 is measured, include capital net gain?

Statutes Involved.

The statutes involved are Sections 21, 22 (a), 23 (n) and 101 of the Revenue Act of 1928 (c. 852, 45 Stat. 791), as follows:

"TITLE I.—INCOME TAX.

PART II.—COMPUTATION OF NET INCOME.

SEC. 21. NET INCOME.

'Net income' means the gross income computed under Section 22, less the deductions allowed by Section 23.

SEC. 22. GROSS INCOME.

(a) *General definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

SEC. 23. DEDUCTIONS FROM NET INCOME.

In computing net income there shall be allowed as deductions: * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

(2) Any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection.

SUBTITLE C—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A—RATES OF TAX.

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) 'Capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets.

(3) 'Capital deductions' means such deductions as are allowed by Section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) 'Ordinary deductions' means the deductions allowed by Section 23 other than capital losses and capital deductions.

(5) 'Capital net gain' means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) 'Capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

Statement.

The facts as stipulated and found are as follows (R. 11–15, 21, 22):

The taxpayer during the taxable year 1928 had net income of $111,648.39, as defined by Section 21 of the Revenue Act of 1928, but before any allowance of a deduction for charitable contributions as provided for by Section 23 (n). Of such statutory net income $66,634.87 was ordinary net income and $45,013.52 was capital net gain, as defined by Section 101 (c). The taxpayer elected to have his capital net gain taxed under the capital net gain provisions in Section 101.

During the taxable year he made charitable contributions within the scope of Section 23 (n) amounting to $27,996.83. He claimed in his tax return, as a deduction for such charitable contributions, the sum of $16,747.26, which was equal to 15 per cent. of his statutory net income of $111,648.39 as computed without the benefit of the deduction for charitable contributions. In auditing the taxpayer's return the Commissioner, consistently with his uniform practice, determined and allowed a deduction for contributions equal to 15 per cent. of the

taxpayer's entire net income, including capital net gain (R. 5, 6), but while this proceeding was pending before the Board, and because of the view then temporarily taken by the Board in the *Elkins* case, the Commissioner filed an amended answer alleging error in such allowance. (R. 10.) The Board of Tax Appeals decided that his charitable contributions should be limited to 15 per cent., not of his net income, but of his ordinary net income. The Circuit Court of Appeals reversed the Board and held that the taxpayer's computation and the Commissioner's original computation are correct.

Summary of Argument.

Stripped of legal verbiage the question in essence is whether or not the whole is equal to the sum of its parts.

The statute provides (Section 23 (n)) that the 15 per cent. limitation shall be based on "net income." The Government's present contention is that, where the taxpayer elects to have his capital net gain subjected to tax under Section 101 of the statute, the 15 per cent. limitation shall be based on ordinary net income instead of net income, although it is not disputed that capital net gain is included in net income. According to the Government, the sum of capital net gain plus ordinary net income is not equal to, but exceeds, net income. The fallacy in the Government's contention lies in attempting to apply Section 101 before the net income, upon which the deduction for contributions is based, is determined under Sections 21, 22 and 23, and in failing to recognize that Section 101 provides only for the calculation of the tax and for the classification of net income, and not at all for the determination of net income. The Government confuses the two operations of the computation of net income and the computation of the tax.

For a number of years the revenue acts have allowed a deduction from gross income for charitable contributions limited to 15 per cent. of net income before deducting such charitable

contributions. In the Revenue Act of 1921 provision was made for an optional tax on net gain derived from the sale of capital assets held over two years, and for the purpose of computation of such tax net income was divided into capital net gain and ordinary net income. In the Revenue Act of 1924 the provision was extended to apply to capital net losses. Until 1932 the construction of the statute by the Treasury Department was consistent that both capital net gain and capital net loss, being part of net income, should be taken into account in determining the maximum deduction for charitable contributions. The Government's present position is not supported by the Board of Tax Appeals or by the courts.

The respondent accordingly maintains the following propositions:

1. A taxpayer is entitled to the allowance as a deduction in computing his net income of charitable contributions to an amount which does not exceed 15 per cent. of his net income as computed without the benefit of such deduction, irrespective of whether or not the taxpayer's net income includes capital net gain.

2. The rulings and practice of the Bureau of Internal Revenue from 1917 to 1932 have consistently allowed for charitable contributions 15 per cent. of the taxpayer's net income, including capital net gain.

3. The 15 per cent. charitable deduction provision was placed in the Revenue Acts for the benefit of charitable institutions and to encourage charitable giving, and the Act should be interpreted to accomplish this result.

4. The argument advanced by the Commissioner, besides being opposed to his own long-continued administrative construction under several reenactments of similar provisions of law, has been rejected by the Board of Tax Appeals and the Federal Courts.

ARGUMENT.

I.

A taxpayer is entitled to the allowance as a deduction in computing his net income of charitable contributions to an amount which does not exceed 15 per cent. of his net income as computed without the benefit of such deduction, irrespective of whether or not the taxpayer's net income includes capital net gain.

Section 23 (n) provides that in computing net income there shall be allowed as a deduction charitable contributions to an amount which does not exceed 15 per cent. of the taxpayer's "net income" as computed without the benefit of such deduction. Accordingly, charitable contributions are deductible in computing net income to the extent that they do not exceed 15 per cent. of net income before deducting such contributions. There is no other limitation, and the amount of the deduction for charitable contributions is readily determinable and fixed as soon as the amount of charitable contributions and the amount of the net income as computed without the benefit of the deduction of such charitable contributions are known. If, then, the charitable contributions are $15,000 and the net income before deducting such contributions is $100,000, it is clear that $15,000 may be deducted from the $100,000 in computing net income.

But what does the statute mean by "net income"? As the meaning of this term is defined in the statute itself, there is no uncertainty as to its meaning. We have only to look to section 21, which provides that "net income" means the gross income computed under section 22, less the deductions allowed by section 23. This is the sole and exclusive definition of net income in the statute.

As was stated by the Circuit Court of Appeals for the Second

Circuit, in *American Can Co.* v. *Bowers*, 35 Fed. (2d) 832, 835, certiorari denied, 281 U. S. 736,

> "Necessarily, net income, for tax purposes, is a conception of the income tax statute, and the amount arrived at is ascertained by deducting from the gross amount of income received by the taxpayer from *all sources* the specified deductions allowed to it by statute." (Italics ours.)

Referring to section 22, it appears that gross income includes gains, profits and income derived, among other things, from dealings in property, and, in general, gains, profits and income derived from any source whatever. It is evident that gain from the sale of capital assets is included in gross income. Referring further to section 23, we find that various deductions are allowable from gross income in computing net income, and that among them is the provision for the deduction of charitable contributions under section 23 (n), already discussed. Adopting the figures used above, there is no room for dispute, therefore, that the net income in our supposititious case is $85,000.

Now it does not follow that all portions of our net income of $85,000 may be taxed at the same rates or in the same manner. Section 25 provides that for the purpose of the normal tax there shall be credited against net income dividends, interest on United States obligations, the personal exemptions for single and married persons, and the credit for dependents, so that not all of the net income is subject to normal tax, but only to surtax. Section 31 provides for a special classification of net income in the form of earned net income, and taxes earned net income at a lower rate than other net income. Section 102 provides that in the case of gains from the sale of mines, where the principal value of the property has been demonstrated by prospecting, exploration and discovery work done

by the taxpayer, the surtax shall not exceed 16 per cent. of the selling price. None of these provisions or others similar to them affects the determination of net income, which is solely subject to the provisions of sections 21, 22 and 23, above cited.

Having seen that the determination of net income is expressly and definitely provided for, and that various classes of net income may be differently taxed without disturbing the computation of net income, we pass to section 101, which provides for the tax in respect of capital net gain, which is merely another division or class of net income. In this section capital net gain is contrasted with ordinary net income, and even before scrutinizing the statutory provisions it would appear logical and sensible that such part of net income as was not capital net gain would be ordinary net income. In other words, the sum of capital net gain and ordinary net income would necessarily be net income. This conclusion is supported by sections 168 and 186 relating respectively to capital net gains and losses in the cases of estates or trusts and partnerships, both sections providing that "the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations," etc.

But, naturally, the provisions of section 101, unless ambiguous, must control. Perhaps we should first examine the definition of our terms. "Capital gain" and "capital loss" give little trouble, and "capital deductions" and "ordinary deductions" expressly include all the deductions allowed by section 23. In order to arrive at capital net gain there is subtracted from the capital gain the sum of the capital deductions and capital losses, plus any amount by which the ordinary deductions exceed the gross income computed without including capital gains, which means that if the ordinary deductions exceed the gross income exclusive of capital gains, then net

income comprises solely capital net gain. The definitions just mentioned are helpful, but perhaps not conclusive.

Apparently the crux of the matter, aside from the definition of net income, is the definition of ordinary net income. Subdivision (7) of paragraph (c) of section 101 provides:

> "(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

By ordinary rules of grammar, the second clause, "computed in accordance with the provisions of this title," merely explains and identifies what is meant by the expression "net income." In other words, section 101, where it speaks of net income, means the net income which has been computed in accordance with sections 21, 22 and 23, but "ordinary net income" means such net income after excluding all items of capital gain, capital loss and capital deductions, that is to say, after excluding capital net gain, or capital net loss. The only other possible construction would be to pay no attention to the second comma, between "title" and "after," and attempt to arrive at an anomalous net income by first excluding items of capital gain, capital loss, and capital deductions. That, however, would not be net income, and an analysis of the provision can leave no doubt that one must start with net income as computed in accordance with sections 21, 22, and 23, and then exclude all items of capital gain, capital loss and capital deduction in arriving at ordinary net income.

Were there no statutory definition of "net income," as in section 21, the definition of "ordinary net income" in section 101 (c) (7) would alone suffice to show beyond any question that capital gain is included in "net income," for the provision excluding capital gain, capital loss and capital deductions from net

income in order to arrive at ordinary net income would be meaningless unless capital gain, capital loss and capital deductions were used in computing net income to start with.

There is further internal evidence that capital gains were intended to be included in gross income for the purpose of computing the net income on which the deduction for contributions is based. Section 101 (c) (5) defines "capital net gain" as the excess of total capital gain over the sum of (A) capital deductions and capital losses plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains. Why should the Congress specify "gross income" computed without including capital gains, unless where the term is used without such limitation, as in section 22, "gross income" includes capital gains?

A further clear indication that all items of gross income and deductions that may be found in the statute are included in sections 22 and 23, is derived from the fact that sections 101 (c) (3) and 101 (c) (4) show plainly that the capital deductions and ordinary deductions are, together, those deductions found in section 23.

Referring to our original illustration of net income of $100,000 before deduction of contributions and net income of $85,000 determined by deducting contributions of $15,000, let us assume that such net income is made up of capital net gain of $45,000 and ordinary net income of $40,000. As we have seen, section 101 does not require a recomputation of net income, but merely the division, for the purpose of calculating the tax, of net income *previously computed* into the two classes of capital net gain and ordinary net income. As in calculating the capital net gain, it may be assumed, we did not take into account the deduction of $15,000 for charitable contributions, that being an ordinary deduction, it follows, since

the sum of capital net gain and ordinary net income equals net income, that automatically the deduction of $15,000 for charitable contributions is given effect in arriving at ordinary net income.

Having seen that the meaning of the terms used is clear, the operating provisions of section 101 present no issue. Paragraph (a) provides that in the case of any taxpayer, other than a corporation, who derives capital net gain, there shall at the election of the taxpayer be paid in lieu of other taxes a tax determined by first computing a partial tax upon the basis of the ordinary net income at the rates and in the manner as if section 101 had not been enacted and by regarding the total tax as such amount plus 12½ per cent. of the capital net gain. There is no suggestion here of recomputing net income; there is simply a special provision for determining a tax upon net income which includes or comprises capital net gain. There is no more necessity for recomputing net income than there would be where net income includes dividends, earned income or interest on Government bonds.

That the capital net gains provisions simply prescribe a rate of tax on a *kind* of net income is disclosed by a reference to the title of the provisions. The title is "SUBTITLE C—SUPPLEMENTAL PROVISIONS," "SUPPLEMENT A—RATES OF TAX," followed by the specific provisions of Section 101, "Capital net gains and losses." The provisions are part of Title I of the Act, which covers all income tax. More specifically, the capital net gains and losses provision, by its own caption, has reference entirely to "rates of tax" applicable to the capital net gains and losses provisions of the "income tax" title of the act. The purpose is plain to impose a different rate of tax on capital gains from the rates applicable to other kinds of net income.

Moreover, it is to be noted from Judge Swan's opinion in the *Bliss* case that in 1928 the Government was arguing in his

Court that the capital gains provisions related "merely to rates and did not affect the computation of the allowance of charitable deductions," which argument was accepted by the Second Circuit at that time and tacitly approved by this Court in denying a writ of certiorari in *Sadowsky* v. *Anderson*, 29 Fed. (2d) 677, certiorari denied, 279 U. S. 849.

Furthermore, the record in this case shows that, in determining the deficiency against this taxpayer, the Commissioner referred to the taxpayer's "Net income including capital gain as shown on return," increased the capital gain, and consequently increased proportionately the deduction for contributions, and then stated the taxpayer's "Net income adjusted,"—in which he included capital gains. See the Commissioner's deficiency letter to the taxpayer. (R. 5.)

The inference conveyed by the foot note to the Commissioner's brief in the *Bliss* case (page 12) is therefore somewhat misleading, unless it be considered in connection with the further explanation that the tax returns prescribed by the Internal Revenue Bureau make provision for the separate statement of each of the different kinds of net income received by a taxpayer, such as wages, interest, dividends, partnership profits, capital gains and the like, all for convenience in auditing the returns and applying the proper rates of tax to the different kinds of income.

The Commissioner's argument necessarily suggests that perhaps Congress meant to penalize a taxpayer for taking advantage of the tax on capital net gains. Certainly no evidence of any such intention exists in the statute. The provision for the special taxation of capital net gains was designed at least as much for the benefit of the Government as of taxpayers, it being thereby intended to enable taxpayers to realize gain taxable at a reasonable rate on the sale of property which they could not afford to sell if the gain were to

be subject to high surtaxes. It was thought that by removing the prohibitive tax theretofore applied upon profits derived from the sale of capital items, the effect would be to "materially increase the revenue" by stimulating profit-taking transactions. See House Report No. 350, 67th Congress, First Session, and Senate Report No. 275, 67th Congress, First Session, p. 12. Also see the discussion in Congress, Congressional Record, Vol. 61, Part 5, pages 5175–76, 5289; Vol. 61, Part 7, page 6576. Cf. *Burnet* v. *Harmel*, 287 U. S. 103, 106; *Helvering* v. *New York Trust Co.*, 54 S. Ct. 806. The provision is clearly remedial legislation.

The fallacy in the Commissioner's argument herein lies, we think, in attempting to apply section 101 before the net income upon which the deductions for contributions is based is determined under sections 21, 22 and 23, and in failing to recognize that section 101 provides only for the calculation of the tax and for the classification of net income, and not at all for the determination of net income. The effect of the Commissioner's contention is to call for the computation of a hybrid net income which is neither the net income determined under sections 21, 22 and 23 as prescribed by the statute, nor ordinary net income defined by section 101 and to be calculated by excluding from net income all items of capital gain, capital loss and capital deductions. We venture to repeat and to emphasize that before resorting to section 101 the taxpayer's net income must first be determined under sections 21, 22 and 23, involving the deduction from gross income of all the allowances specified in section 23, including charitable contributions up to 15 per cent of the taxpayer's net income (as defined in section 21) before deducting such charitable contributions. Once statutory net income be determined, the proper application of section 101 is not confusing.

The interpretation herein contended for is in harmony with

the obvious meaning of the words "net income" as used elsewhere in the same act.

Section 120 of the Revenue Act of 1928 provides as follows:

> "SEC. 120. UNLIMITED DEDUCTIONS FOR CHARITABLE AND OTHER CONTRIBUTIONS.
>
> "In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 23 (n) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable."

There certainly is no doubt what Congress intended by the words "net income" in this section; it means net income as defined by section 21 and it does not mean "ordinary net income." The purpose of Congress is clear in the case of the person who for ten years pays out 90 per cent of his income for charity or taxes; the 15 per cent limitation does not apply to him if he gives away practically all his money to charity. In Report No. 398, Sixty-fifth Congress, First Session, Senate Finance Committee, covering the Revenue Act of 1924, it is stated, on the subject of the unlimited deduction for charitable contributions, at page 24 as follows:

> "This provision is designed substantially to free from income taxation one who is habitually contributing to benevolent organizations amounts equalling virtually his entire income."

The Commissioner would not argue that net income in section 120 meant "ordinary net income" and not exactly what the section says—"net income," which is clearly defined in section 21.

We have previously pointed out that in Section 168, relating to estates and trusts, and in Section 186, relating to partnerships, the 1928 Act provides that a beneficiary's or partner's "proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner," etc. Here, if any further definition than that contained in Section 21 were required, is an explicit statutory declaration that "net income" includes capital net gains.

The interpretation contended for by the Commissioner would produce absurd results.

As an illustration of the inequitable operation of the statute, under the Commissioner's present argument, assume three taxpayers who have made charitable contributions of $50,000.00 each and whose respective incomes are as follows:

	A.	B.	C.
Gain (or loss) from business	($100,000.00)	$100,000.00	$300,000.00
Gain (or loss) from the sale of capital assets	300,000.00	100,000.00	(100,000.00)
Net income (before a deduction for contributions)	200,000.00	200,000.00	200,000.00

In accordance with the provisions of section 23 (n) and the statutory definition of "net income," there is an allowable deduction for contributions, within the 15 per cent limitation, of $30,000.00 in each of the above cases. Following the Commissioner's contention, the amount of the deduction would be determined not by the *amount* of net income, but by the *kind* of net income. Under that view, A would be allowed a deduction for contributions of zero, B a deduction of $15,000.00 and C a deduction of $45,000.00,—despite the fact that each has the same statutory net income. The statute, however, reenacted several times without change in this regard and

consistently so interpreted in its administration, has made the amount of the deduction for charitable contributions depend on the *amount* and not on the *kinds* of net income.

It is not to be presumed, without clear provision to the contrary, that taxpayers having the same economic and statutory net income are to be treated so differently.

The phrase "net income" is a phrase of technical meaning, as pointed out in *American Can Co.* v. *Bowers*, *supra*, being a phrase of statutory conception. Its technical meaning is defined in the statute itself. The phrase having been given in legal formulae a fixed, definite and certain meaning, that meaning is conclusively presumed to be what Congress meant in the premises. *Central Union Trust Co.* v. *Edwards*, 287 Fed. 324, 326, certiorari denied, 262 U. S. 744. Therefore, there is no possible ground, if otherwise under any circumstances any existed, for the Commissioner's resort for a meaning of the phrase, as he has in his brief in the *Bliss* case, to the language used by a private citizen before a committee of Congress in informal discussion at hearings on a bill much amended in its passage. Congress itself having defined the phrase, no judicial body has the power to give it a different meaning. *Schweizer* v. *Mager*, 297 Fed. 334, 335; *In re Monrovia Evening Post*, 199 Calif. 263, 248 Pac. 1017, 1020.

Moreover, the phrase "net income" having been defined in the Act, where the same phrase is used elsewhere in the Act, as in section 23 (n), it is presumed to have been used with the same meaning. *United States* v. *Merriam*, 263 U. S. 179. That Congress intended the phrase to have the same meaning wherever used in the act is conclusively shown by reference to Sections 168 and 186, referred to *ante*, p. 9.

II.

The rulings and practice of the Bureau of Internal Revenue from 1917 to 1932 have consistently allowed for charitable contributions 15 per cent. of the taxpayer's net income, including capital net gains.

The deductions for charitable contributions were first authorized by the Revenue Act of 1917, Section 1201 (2) (40 Stat. 330). The regulations relating to that Act (Reg. 33 Rev.) interpreting this provision, provided as follows:

> "Par. 88. Taxable net income, as used in Section 5 (a), ninth deduction, is construed to mean gross income, less deductions (except ninth deduction above) and less excess profits tax, if any."

The Revenue Act of 1917 did not provide for capital net gains or capital net losses; these features of our present Revenue Acts were introduced later. The capital net gain provisions was introduced in the Act of 1921 and the capital net loss feature was introduced in the Act of 1924. However, even after the passage of the Act of 1921, and also the Act of 1924, introducing the capital net gain and loss provisions, no change was made by the Bureau of Internal Revenue in the computation of net income so far as charitable deductions were concerned. The policy with respect to Capital Gains is set forth in a telegram to A. B. Trudgian, New York, signed by the Deputy Commissioner, E. W. Chatterton, and dated February 6th, 1923 (Corp. Trust Co. Fed. Income Tax Service, 1924, Par. 2033):

> "Contributions; 15% limitation; Capital Net Gains: fifteen per cent. limitation for deductions account charitable contributions applies to total net income inclusive of gain from sale of capital assets."

This was followed by a ruling of the Commissioner, promulgated in 1924,—I. T. 2104, Cum. Bull. III-2, p. 152, with respect to Capital Losses, as follows:

"Article 251: Charitable contributions. III-45-1863 I. T. 2104.

"Revenue Acts of 1918, 1921 and 1924.

"Capital losses can not be excluded in computing net income for the purpose of determining the amount of charitable contribution deductions.

"Advice is requested as to whether capital losses may be excluded in determining net income for the purpose of computing the amount of charitable contributions allowable as deductions under the Revenue Acts of 1918, 1921 and 1924.

"Under the provisions of Section 214 (a) 11 of the Revenue Acts of 1918 and 1921 and Section 214 (a) 10 of the Revenue Act of 1924, contributions or gifts made by an individual to organizations organized and operated exclusively for charitable or other specified purposes are deductible to an amount not in excess of 15 per cent. of the taxpayer's net income, including such payments.

"Section 212 of the Revenue Acts of 1918 and 1921 defines the term 'net income' as follows:

"(a) That in the case of an individual the term 'net income' means the gross income as defined in Section 213, less the deductions allowed by Section 214.

"Net income is defined by Section 212 of the Revenue Act of 1924 as follows:

"(a) In the case of an individual the term 'net income' means the gross income as defined in Section 213, less the deductions allowed by Sections 214 and 206.

"Section 206 of the Revenue Act of 1921 and Section 208 of the Revenue Act of 1924, pertaining to capital gains and losses, do not allow as a deduction any loss resulting from the sale or exchange of capital assets that is not deductible under Section 214 or that does not enter into the computation of a net loss deductible under Section 206

of the Revenue Act of 1924. Such sections merely give the taxpayer the option of being taxed at the rate and in the manner therein provided instead of at the rates and in the manner provided by Sections 210 and 211.

"Inasmuch as losses resulting from the sale or exchange of capital assets are deductible under Section 214 of the Revenue Acts of 1918, 1921, and 1924, and enter into the computation of the net loss that is deductible under Section 206 of the Revenue Act of 1924, it follows that such losses can not be excluded in computing the net income for the purpose of determining the amount of charitable contributions that are deductible under Section 214 (a) 11 of the Revenue Acts of 1918 and 1921 and Section 214 (a) 10 of the Revenue Act of 1924."

The case of *Hallie D. Elkins* v. *The Commissioner*, 24 B. T. A. 572, was decided by the Board of Tax Appeals November 3d, 1931. It held that where the taxpayer had sustained capital net losses, these capital net losses should be disregarded in the computation of charitable gifts to the extent of 15 per cent of the taxpayer's net income. This decision was contrary to the above I. T. 2104, and the Commissioner, on January 27th, 1932, referring to the *Elkins* case (Mim. 3931, XI-1 C. B. 33) said:[1]

"The Board's decision is contrary to the position which the Bureau has consistently followed as announced in I. T. 2104 (C. B. III-2, 152). The decision will be appealed, and in the audit of returns involving capital net losses, the Bureau will continue to follow I. T. 2104."

Thus, the Commissioner himself admitted that he had

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[1] The Commissioner, as indicated in his mimeograph 3931, recommended that the Board's decision in the *Elkins* case be appealed, but the then Solicitor General refused to authorize an appeal.

consistently followed the position here urged by the petitioner; and that his rules and regulations favorable to the respondent were consistently followed by him, although changes were made in the law by the Act of 1921 and the Act of 1924. As was stated by the Supreme Court in *Brewster* v. *Gage*, 280 U. S. 327:

> "These regulations were prepared by the Department charged with the duty of enforcing the Acts. The rule so established is reasonable and does no violence to the letter or spirit of the provisions construed. A reversal of that construction would be likely to produce inconvenience and result in inequality. It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons."

It is a well settled rule of construction that if Congress re-enacts a statute in substantially the same terms as a prior Act and there has been an administrative or judicial construction of the prior Act, it is tantamount to the adoption of that construction, for Congress is presumed to have knowledge of such construction. *United States* v. *Falk*, 204 U. S. 143, and *National Lead Co.* v. *United States*, 252 U. S. 140. In the latter case, the Court said:

> "* * * It has been the settled law that when uncertainty or ambiguity, such as we have here, is found in a statute, great weight will be given to the contemporaneous construction by Department officials, who were called upon to act under the law and to carry its provisions into effect,—especially where such construction has been long continued, as it was in this case for almost forty years before the petition was filed. * * *
>
> "To this we must add that the Department's interpretation of the statute has had such implied approval

by Congress that it should not be disturbed, particularly as applied to linseed and its products."

It will be remembered that since the Act of 1917 was passed and the first regulation was made by the Commissioner of Internal Revenue, not only have the Acts of 1921 and 1924 been passed, with their relative regulations and rulings above referred to, but also the Acts of 1926, 1928 and 1932 have been passed and Congress has made no change in the law.

Though the assertion is made in the Government's brief in the *Bliss* case (page 24) that, following the *Elkins* decision, the Bureau's position has been entirely consistent with the position taken in this case, a consideration of the facts indicates the contrary.

Following the *Elkins* decision, as we have pointed out, the Commissioner published Mim. 3931, stating that the *Elkins* decision was contrary to his position and would be appealed, and providing in effect that the procedure to be followed in all cases involving the issue was that the view most favorable to the Government was to be taken. However, the Solicitor General refused to authorize an appeal. Consequently all the Commissioner could do was to refuse to follow the *Elkins* decision, which he did. Thereafter the Board's opinion in the *Harbison* case was promulgated and Mim. 3986 was published (XI-2 C. B. 29), stating that the Bureau's original position in I. T. 2104 was to be followed in certain respects and that the Board's position in the *Harbison* case was to be followed in others. In G. C. M. 11324 (XI-2 C. B. 267), the next official pronouncement, the view was taken that the original position of the Bureau was correct under the 1918 and 1921 Acts, and I. T. 2104 was modified only to the extent that it was affected by the Board's decision in the *Elkins* case under the 1924 Act.

Following the *Straus* decision, the Commissioner directed that in the audit of returns "in order fully to protect the interests of the Government and the taxpayers pending a final decision of court on the question" certain procedure be followed. See I. T. Mim. 4028, 1933 C. C. H., para. 6323.

III.

The 15 per cent. charitable deduction provision was placed in the Revenue Acts for the benefit of charitable institutions and to encourage charitable giving, and the Act should be interpreted to accomplish this result.

The issue before this Court is not merely how much taxes the respondent must pay; it is an issue that vitally concerns all charities. The religious, charitable, scientific, literary and educational institutions are as much interested in the decision of this Court as the respondent. The provision allowing charitable deductions to the extent of 15 per cent. of the taxpayer's net income was first inserted in the Act of 1917. Senator Hollis, in his amendment to the Act, proposed a deduction of 20 per cent., and, when he introduced his amendment on September 7, 1917, said (Congressional Record, Vol. 55, Part 7, page 6728):

> "The effect of that amendment will be to permit a wealthy man to contribute to charitable, educational and scientific institutions, and then when he comes to make up his income tax return to make a deduction from his gross income of the amount that he has contributed for these purposes, not to exceed 20 per cent. of his entire net income. * * * I understand ex-President Taft has written to the Committee stating that, in his judgment, institutions like Hampton Institute will be seriously handicapped unless this amendment is adopted.

> "It will work in this way: usually people contribute to charities and educational objects out of their surplus. After they have done everything else they want to do, after they have educated their children and travelled and spent their money on everything they really want or think they want, then, if they have something left over, they contribute it to a college, or to the Red Cross or for some scientific purposes. Now, when war comes and we impose these very heavy taxes on income, that will be the first place where the wealthy man will be tempted to economize, namely, in donations to charity."

On his agreeing to alter the amount from 20 per cent. to 15 per cent., the amendment was adopted.

Many of the large contributions to charitable institutions are made by taxpayers when they derive a substantial capital gain; it is only human nature to give more abundantly when one has realized handsomely upon a fortunate investment than when one has merely a fixed income or sustains losses. The point is well illustrated in this case. The respondent gave liberally in aid of worthy causes. While his total taxable income, without any deduction for contributions, was only $111,648.39, he made contributions in the amount of $27,996.83.

Congress adopted in 1917 the policy of encouraging charitable gifts to sustain charitable institutions. That the provisions allowing a deduction for charitable contributions was intended by Congress to encourage charitable gifts is recognized by the Bureau of Internal Revenue. See Law Opinion 1118, II-2, C. B. 148. The construction now contended for by the Commissioner would absolutely destroy this incentive when the taxpayer has made capital gains; the construction contended for by the respondent fulfills the purpose of Congress and such an interpretation should be sustained.

Moreover, for years past, while the Commissioner was

consistently following his rules and regulations during the various enactments of new revenue laws, people who had made large capital gains, relying upon such rules and regulations, gave liberally to charities, feeling assured that they could deduct the amount of their gifts up to 15 per cent. of their net incomes. The position as now contended for by the Commissioner is, practically, a breach of faith with them.

IV.

The argument advanced by the Commissioner, besides being opposed to his own long-continued administrative construction under several reenactments of similar provisions of law, has been rejected by the Board of Tax Appeals and the federal courts.

It seems hardly necessary to deal in detail with the argument advanced by the Commissioner, in view of the fact that such argument is directly opposed to the Commissioner's own long-continued administrative construction of the law under several reenactments of similar provisions of the statute, and in view of the fact that such argument has been rejected by the United States Board of Tax Appeals and all the federal courts which have dealt with the subject.

It does not seem unfair, however, to point out that the Commissioner is obviously hard driven for support when he finds it necessary to advance, as indicative of the legislative intent of the statute, the language used by a private citizen before a Congressional committee in the first stages of a bill which was much changed in the course of its passage through Congress, even if that language could be distorted to support the Commissioner (Petitioner's brief, *Bliss* case, p. 13). It is scarcely to be believed that the reasonable intent of the statute, which seems plain from the language used, and which has

received the Commissioner's own administrative construction, approved by Congress by virtue of several reenactments of similar provisions of law, is now recently discovered by the Commissioner to be altogether different from what he had formerly held it to be, and that such intent is to be derived from the language used by a private citizen in informal discussion with committees of Congress. But, even if recourse be had to that discussion, or to the discussion of Dr. Adams with Senator Smoot, to which the Commissioner refers, there is nothing shown which is contrary to the Commissioner's former position and the respondent's present position. Those discussions simply show that the object was, as we have pointed out, page 13, *ante*, to afford a different rate of tax on capital gains for the purpose of stimulating, to the advantage of the Treasury, taxable sales of capital assets.

The *Westfeldt* case, referred to in the Commissioner's brief, did not at all involve the question of the computation of "net income" for the purpose of determining the amount of deduction allowable for contributions, and it illustrates nothing more than that the capital gains and capital net loss provisions simply affect the rate of taxation, as does the amount of dividends or the amount of a taxpayer's earned income.

The decision of the Board of Tax Appeals in *Elkins* v. *Commissioner*, 24 B. T. A. 572, was followed in *Harbison* v. *Commissioner*, 26 B. T. A. 896; *Bliss* v. *Commissioner*, 27 B. T. A. 205; and *Colgate* v. *Commissioner*, 27 B. T. A. 506, in opinions by individual members of the Board and without review by the entire Board of sixteen members. When the question came to be reconsidered in *Straus* v. *Commissioner*, 27 B. T. A. 1116 (April 6, 1933), it was reviewed by the entire Board which held in accordance with the Commissioner's administrative construction and the respondent's argument herein, and declared that its prior decisions on the

question were in error and would no longer be followed. The Board's decision in the *Straus* case was followed in its opinion in this case (R. 17), and has been followed in all cases since decided involving the same question. The opinions in those cases were by memorandum and have not been published, but may be found in the following Board proceedings: *Woodward* v. *Commissioner*, Docket No. 65517 (April 10, 1933); *Robinette* v. *Commissioner*, Docket No. 53905 (April 10, 1933); *Watkin* v. *Commissioner*, Docket No. 65513 (May 10, 1933); *Igleheart* v. *Commissioner*, Docket No. 45571 (September 20, 1933); *Poor* v. *Commissioner*, Docket No. 58186 (January 22, 1934); *Watts* v. *Commissioner*, Docket No. 66111 (February 2, 1934).

The *Bliss*, *Harbison* and *Colgate* cases were appealed to the Circuit Court of Appeals for the Second Circuit. The Commissioner there advanced the same arguments he advances here. They were rejected. See the opinion of the Court, by Judge Swan, in the case of *Bliss* v. *Commissioner* 68 Fed. (2d) 890.

The opinion in the Bliss case completely disposes of the argument advanced by the Commissioner. It is interesting to note that Judge Swan points out that the Government argued before his Court in 1928, as the taxpayer argues here, that the capital gains provisions related merely to rates and did not affect the computation of the allowance of charitable deductions.

In addition to the opinion of the Second Circuit, the United States District Court for the Northern District of Illinois, in the case of *George Waller Blow and Wayne Chatfield-Taylor, as Administrators* v. *United States*, decided September, 1933, not reported in Federal Reports but to be found in 1933 C. C. H. para. 9507, and the United States Circuit Court of Appeals for the First Circuit, in the case of *White* v. *Atkins, Collector*, 69 Fed. (2d) 960, affirming *Atkins* v. *White*, 3 Fed. Supp. 694,

have rejected the arguments here advanced by the Commissioner and have held in favor of the contentions made by the respondent.

In short, in all tribunals where the matter has been decided the Government's argument has been rejected.

CONCLUSION.

It is submitted that the statutory definition of the term "net income" is clear and unambiguous and requires no strained interpretation; that if any construction or interpretation is required, the construction here advanced by the respondent, and consistently advanced by the Commissioner under several reenactments of similar provisions of the statute, is the proper construction; that the position advanced by the Commissioner herein would work obvious absurdities and injustices and defeat the benevolent purposes of the statutory provision allowing deductions for charitable contributions; that the decisions of the United States Board of Tax Appeals in this case and of the federal courts in similar cases, all in harmony with the Commissioner's own previous position, are correct; and that the Commissioner's argument herein should be rejected and the judgment of the Circuit Court of Appeals affirmed.

Respectfully submitted,

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